

FILED: JULY 24, 2000

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA

In re)	Bankruptcy Case
)	No. 97-30879DM
GOLDEN ADA, INC.,)	
)	
Debtor.)	
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In re)	No. 97-30877DM
)	
SHAKO REAL ESTATE MANAGEMENT, INC.,)	
)	
Debtor.)	
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In re)	No. 97-30880DM
)	
SHAKO ENERGY, INC.,)	Chapter 7
)	
Debtor.)	(Substantively Consolidated)
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MEMORANDUM DECISION

In February 1998, the Tax Collector of the County of Contra Costa (the "Tax Collector") filed a proof of claim against Shako Real Estate Management, Inc. ("Debtor") for certain unpaid real property taxes, penalties and interest thereon; the proof claim asserted a secured claim in the amount of \$160,346.30. Charles E. Sims, Chapter 7 trustee in the above-captioned consolidated cases ("Trustee") objected to the Tax Collector's claim, alleging that the delinquency penalties and redemption penalties should be subordinated to general unsecured claims pursuant to 11 U.S.C. §

1 726(a)(4).¹ Even though the Tax Collector denominated
2 approximately \$51,681 as redemption penalties, he argued that
3 they were not punitive impositions but "interest" on a secured
4 claim not subject to subordination under section 726(a)(4). In
5 making this argument, the Tax Collector relied on California
6 Revenue and Taxation Code section 4103(b), which provides:

7 For purposes of an administrative hearing or any claim
8 in a bankruptcy proceeding pertaining to the property
9 being redeemed, the assessment of penalties determined
10 pursuant to subdivision (a) with respect to redemption
of that property constitutes the assessment of
interest.

11 Cal. Rev. & Tax. Code § 4103.

12 As noted by the Trustee in his reply, a state statute's
13 characterization of an assessment as "interest" rather than as a
14 "penalty" is not relevant in determining whether the assessment
15 is a penalty for the purposes of the Bankruptcy Code:

16 [The state tax collection agency] correctly maintains
17 that courts distinguishing between taxes and penalties
18 in the bankruptcy context should look to the actual
operation of the provision in question; indeed, the
Supreme Court recently reaffirmed this principle.

19 ¹Section 726(a)(4) provides:

20 (a) Except as otherwise provided in section 510 of this
21 title, property of the estate shall be distributed --

22 * * *

23 (4) fourth, in payment of any allowed claim,
24 whether secured or unsecured, for any fine, penalty, or
25 forfeiture, or for multiple, exemplary. Or punitive
26 damages, arising before the earlier of the order for
27 relief or the appointment of a trustee, to the extent
that such fine, penalty, forfeiture, or damages are not
compensation for actual pecuniary loss suffered by the
holder of such claim.

1 [Citations omitted]. Therefore, to determine whether
2 [the taxing agency's] assessments are noncompensatory
3 penalties, we look behind the statutory label
4 ("penalty") and examine the "actual effects" of the
5 assessments. [Citation omitted]. The Supreme Court
6 summarized this functional analysis as follows: 'A tax
7 is an enforced contribution to provide for the support
8 of government; a penalty, as the word is here used, is
9 an exaction imposed by statute for an unlawful act.'

10 State of Washington v. Hovan, Inc. (In re Hovan, Inc.), 96 F.3d
11 1254, 1257 (9th Cir. 1996), quoting United States v. Reorganized
12 CF & I Fabricators of Utah, Inc., 518 U.S. 213 (1996). If the
13 assessment "has no direct relation to any specific costs incurred
14 by the state," its "actual effect" is generally punitive and not
15 compensatory in effect. Hovan, 96 F.3d at 1257.

16 In this case, the "actual effect" of the redemption
17 penalties at issue is to punish a delinquent taxpayer, rather
18 than to compensate the Tax Collector for actual losses. The
19 penalty is imposed at a flat rate of 18 percent per year, and
20 bears no "direct relation to any specific costs incurred" by the
21 Tax Collector. Id. Moreover, section 4103 does not refer to
22 specific costs which are to be compensated by the penalty;
23 rather, the California Revenue and Taxation Code contains two
24 other provisions authorizing the assessment of delinquent costs,
25 thereby compensating the Tax Collector for costs associated with
26 the delinquency. See Cal. Rev. & Tax. Code §§ 2657 and 3351.
27 Finally, the California Supreme Court has also recognized the
28 true purpose of section 4103: "the statutory scheme, when
considered as a whole, clearly indicates that redemption
penalties are merely what the name implies -- charges for the

1 exercise of the privilege of redeeming sold property." Weston
2 Investment Co. v. State of California, 31 Cal.2d 390, 394, 189
3 P.2d 262, 264 (Cal. 1948). Because the "redemption penalties"
4 were correctly designated as such and are punitive in nature,
5 they must be accorded fourth priority under 11 U.S.C. §
6 726(a)(4).

7 In any event, under the Supremacy Clause of the United
8 States Constitution, the attempted bankruptcy carve-out of
9 section 4103 is unenforceable. Section 4103's designation of
10 redemption penalties as interest "for purposes of . . . any claim
11 in a bankruptcy proceeding" seemingly reflects an effort by the
12 state legislature to avoid the priority scheme of Bankruptcy Code
13 section 726 (in particular, subsection (a)(4)). To the extent
14 that section 4103 adopts a bankruptcy-specific exception, it
15 "stands as an obstacle to the accomplishment and execution of the
16 full purposes and objectives of Congress and is pre-empted by
17 federal bankruptcy law. See Hillsborough County v. Automated
18 Medical Labs, Inc., 471 U.S. 707, 713 (1985). Section 4103's
19 "express reference" to bankruptcy claims "supports the conclusion
20 that its purpose is to carve out an exception" to the priority
21 scheme of section 726(a)(4). See DiGiorgio v. Lee (In re Di
22 Giorgio), 200 B.R. 664, 670 (C.D. Cal. 1996), vacated on other
23 grounds, 134 F.3d 971 (9th Cir. 1998) (provision of California
24 Code of Civil Procedure permitting enforcement of writs of
25 possession "notwithstanding receipt of a notice of the filing by
26 the defendant of a bankruptcy proceeding" was preempted by the

1 automatic stay provisions of the Bankruptcy Code). Accordingly,
2 this court finds that the priority scheme of the Bankruptcy Code
3 (as found in section 726) preempts section 4103.²

4 In light of the foregoing, the court will enter an order
5 subordinating the Tax Collector's claim for redemption and
6 delinquency penalties to general unsecured claims and requiring
7 the Tax Collector to refund the any amounts paid for these
8 penalties to the Trustee. The Trustee should prepare an order in
9 accordance with this memorandum decision, and comply with B.L.R.
10 9021-1 and 9022-1.

11
12 Dated: July 24, 2000

13 Dennis Montali
14 United States Bankruptcy Judge
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22 ²The court requested the parties to address the meaning of
23 the reference to "administrative hearing" in section 4103 in
24 order to learn whether the concept of penalties deemed interest
25 applied in any meaningful way beyond the bankruptcy setting.
26 While the Trustee's counsel offered some suggestions, the Tax
27 Collector's counsel could not identify any administrative
hearings where penalties might be subordinated. This reinforces
the court's belief that section 4103(b) constitutes an
impermissible attempt to subvert the priorities established by
the Bankruptcy Code.